

This record is a partial extract of the original cable. The full text of the original cable is not available.

050954Z Aug 05

UNCLAS SECTION 01 OF 03 PRETORIA 003145

SIPDIS

DEPT FOR AF/S/JDIFFILY; AF/EPS; EB/IFD/OMA  
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND  
TREASURY FOR OAISA/BARBER/WALKER/JEWELL  
USTR FOR COLEMAN  
LONDON FOR GURNEY; PARIS FOR NEARY

E.O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [EFIN](#) [ETRD](#) [BEXP](#) [KTDB](#) [PGOV](#) [SF](#)

SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER  
August 5 2005 ISSUE

11. Summary. Each week, AmEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Recent Inflation Trends Bring Poor Economic Relief;
  - June's Trade Balance Surplus Eases Concern for Rand;
  - South Africa's July PMI Record Increase;
  - S&P Upgrades South Africa's Currency;
  - Rising Income Creates Potential 1.5 Million Car Consumers;
  - July Slowdown in Car Sales Indicates Possible Market Cooling; and
  - Growth Pause in Current Trading Conditions.
- End Summary.

#### RECENT INFLATION TRENDS BRING POOR ECONOMIC RELIEF

-----

12. Between 1998 and 2004, the average inflation rates have been higher for the rich than for the poor. This trend, however, looks set to be reversed this year. Until October 2004, there were only two periods when prices were rising faster or at the same pace for the country's upper expenditure category. The two rates converged in July 2001 but then for more than three years the very low expenditure group experienced higher inflation, largely because of the rand's weakness and food prices increased disproportionately more than other goods. In January 2002, annual inflation for the lowest income bracket was 9.1 percent versus 4.1 percent for the most affluent group. The past two years have shown substantial recovery in the rand, which appreciated 140 percent against the dollar between 2002 and 2004. In 2005, the rand has shown recent weakness, depreciating 14 percent against the dollar so far, although the depreciation has been mild compared to 2002. In June 2005, inflation for the very low expenditure group was 1.5 percent (y/y) while inflation for the high expenditure group reached 2.7 percent. Lower food prices explain the much of the differential in inflation among expenditure groups. The very poor have seen a real increase in wealth. In 2005, the child welfare and old age grants increased by 5.9 percent and 5.4 percent respectively, substantially above their inflation rate. Higher fuel prices also helped explain the difference in inflation rates as higher income groups tend to own vehicles and consume petrol. Policies of government such as inflation targeting and welfare spending may begin to bring modest relief to South Africa's poor. The robust rand, however, is also blamed for job losses that take their biggest toll on those at the low end of the income scale. Employment numbers from the latest March 2005 Labor Force Survey show that the South African economy created 500,000 new jobs from March 122004. Many of the new jobs are in services, retail and construction, which have benefited from lower interest rates. While inflation is generally lower for all income groups, the poor seem to be doing better, with price increases for lower income groups falling behind welfare increases. Statistics SA has only released consumer inflation by income, ranging from very low to very high-expenditure groups, since 1997. Source: Business Day, August 1.

#### JUNE'S TRADE BALANCE EASES CONCERN FOR RAND

-----

13. June's trade balance showed a surplus of R1.3 billion, in contrast to May's R2.8 billion deficit, according to the latest figures released by the South African Revenue Service (SARS). Economists polled by Reuters expected a trade deficit of about R1.2 billion in June. The latest trade figures also improved the outlook for the rand and interest rates, because of their implications for the current account. A large deficit on the current account, amounting to 3.8 percent of GDP in the first quarter, has

been worrying since it could lead to a weaker rand and higher inflation. An 8.3 percent monthly increase in the value of exports explained June's surplus as the value of imports declined by 5.8 percent. Despite this, the balance for the year to date remains considerably worse than at the same period last year, with a R6.7 billion deficit compared with a R2.1 billion shortfall in 2004. Source: Business Day and Business Report, August 1.

#### SOUTH AFRICA'S JULY PMI RECORD INCREASE

-----

14. South Africa's Purchasing Managers' Index (PMI) increased to an all-time high at 61.7 compared to June's 59.8, as a weaker currency boosted sales orders, but it was too early to call it a recovery for the manufacturing sector. Investec Asset Management head of fixed income Andre Roux said the jump in the index was unexpected and more readings at higher levels in subsequent months would confirm a recovery in manufacturing conditions. The previous record of 60.3 was set in April 2002. South Africa's manufacturing sector contracted by 1.9 percent in the first quarter of 2005, for the first time since 2003, largely hurt by the strong rand. Manufacturing constitutes more than 16 percent of GDP. The rand has depreciated by almost 14 percent against the dollar so far this year, but the trend has only put a small reversal into three years of straight gains, which have eroded exports. However, June's exports do show recent gains. The July PMI increase was driven by a strong showing in two of the PMI's eight sub-indices, measuring business activity and new sales orders. New sales orders climbed to 69 in July from 66.3 in June. Business activity jumped to 69.9 from 60.3 in June. However, other sub-indices such as inventories, suppliers' performance and employment gave up some of their June gains. The seasonally adjusted employment index slipped back to 50.1 after rising to 53.3, but Roux did not believe this began a reversal of an upward trend. If the PMI reading was corroborated in next week's manufacturing production figures for June from Statistics SA, the release of which coincides with a meeting of the Reserve Bank's Monetary Policy Committee, it might indicate that a manufacturing recovery has started. Source: Reuters and Business Day, August 2.

#### S&P UPGRADES SOUTH AFRICA'S CURRENCY

-----

15. International ratings agency Standard & Poor's (S&P) has upgraded South Africa's long-term foreign currency rating from triple B to triple B plus, putting it three levels above the entry-level investment grade rating and bringing South Africa to within one notch of the A category. South Africa's foreign rating is now equal to Poland and Thailand and is one notch ahead of Mexico. S&P's upgrade, prompted by South Africa's stronger economic growth prospects and reduced vulnerability to external shocks, comes after Moody's, a rival ratings firm, upgraded South Africa's credit rating in January 2005. The third of the big rating agencies, Fitch, has put South Africa on positive ratings watch, indicating an upgrade could come later this year. Sovereign credit ratings are a measure of a government's creditworthiness, a higher rating implies less risk for investors, so they will be willing to accept lower yields on that government's debt, making it cheaper for the country and its corporations to borrow on local and international markets. S&P credit analysts are confident that South Africa's economic growth prospects for this year are even better than last year's, expecting the budget deficit to remain within the government's medium-term target of 3 percent of GDP and the general government debt stable at 40 percent of GDP. Although government's record of economic policy management was very good, there were still problems in delivery. S&P remains concerned about unemployment, poverty and income disparity, citing these as negative comparisons against its peers. S&P has upgraded South Africa's debt rating four times in the past 10 years. Source: Business Day and Business Report, August 2, 2005.

#### RISING INCOME CREATES POTENTIAL 1.5 MILLION BLACK CAR CONSUMERS

-----

16. According to a Merrill Lynch research report, there is a potential market of 1.5 million used and new car black consumers due to rising income levels. Providing vehicle finance for households with gross incomes of just over R5000 per month (\$770 using 6.5 rands per dollar) and allowing private leasing could broaden the potential pool of vehicle owners. Only 24 percent of people earning between R4000 (\$600) and R5999 (\$900) per month owned cars according to the South African Advertising Research Foundation. The report showed that a pretax salary of R5700 a month (\$880) would allow someone to buy a used car of about R70,000 (\$11,000), and R9000 a month (\$1400)

would allow someone to buy a new car for about R110,000 (\$17,000) financed over 54 months. Even if the gross household salary was as low as R5,200 (\$800), an "innovative" bank could finance the purchase of a vehicle. Private leasing could add a further 327,000 potential car buyers to the market. Affordability, or the price of cars relative to people's salaries, was also more of a problem in South Africa than in other countries, even though cars became more affordable between 2003 and 2004, the Merrill Lynch report said. While the report expected car sales to slow due to the rise in interest rates it foresaw next year, and the resulting lower disposable income, long-term vehicle-sales growth should remain strong. The small number of car owners, rising income levels and the poor public-transport infrastructure would support vehicle-sales growth of between 6 percent and 12 percent a year for the next five years. Merrill Lynch also warned that a rise in gasoline prices could derail the positive outlook for the vehicle industry. (Business Day, August 2).

17. Comment. South Africa's car producers are dependent on local sales as well as exports. Car production accounts for 7.1 percent of South Africa's economy, making it larger than mining. South Africa produces less than 1 percent of the global yearly car output. End Comment.

#### JULY SLOWDOWN IN CAR SALES INDICATE POSSIBLE MARKET COOLING

-----

18. The first signs that South Africa's car sales market may be cooling emerged with the release of the latest vehicle sales figures, which showed a 6 percent month-on-month decline. However, year-on-year sales by National Association of Automobile Manufacturers of South Africa (NAAMSA) members rose 19.4 percent in July compared with July 2004, slightly below the growth level of about 20 percent that South African car manufacturers have experienced in the past few months. Economists said that the slowdown was in line with expectations of a gradual slowdown to continue for the rest of 2005. New vehicle sales showed strong growth in July, reaching 26.5 percent. Ford Motor Company asserted that the market was just starting to cool, with daily passenger car sales slowing to 1,473 in July, compared with 1,530 in June. Other car manufacturers also noticed a leveling of July sales, although production and stock constraints rather than softening consumer demand were cited as reasons. Source: Business Day, August 3.

#### GROWTH PAUSE IN CURRENT TRADING CONDITIONS

-----

19. July's South African current trading conditions continue to slow, similar to June's trend, although expectations for the next six months remain high. The South African Trade Management Indices (SATMI) consists of two trading indices designed to capture current and future (next six months) trading environments. In May 2005, current trading conditions reached year-to-date highs and the past two months have seen steady declines, with new orders showing the largest declines. July's trade activity index reached 47, compared to June's 49. Monthly expectations about future trading conditions have remained relatively high (over 60) throughout 2005, unchanged from the past two months (June and July). Source: Standard Bank, SATMI, August 4.

110. Comment. Standard Bank publishes the monthly survey consisting of South African Chamber of Business members. The threshold value of the index is 50; when above this level, trading conditions are seen to have improved relative to the previous month, when below, trading conditions have deteriorated. End comment.

FRAZER